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DOW THEORY LETTERS

"THE MARKET AS INTERPRETED UNDER THE DOW THEORY"

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MISREPRESENTATION I have been disturbed of late by some of the things that have been appearing both in the newspapers and in other services pertaining to Dow's Theory. Rhea once remarked that "if all the sentences written in one year which misinterpret Dow's Theory were laid end to end, we would probably have a string of meaningless chatter sufficient to circle the globe." When a good setter is crossed with a fine poodle the result is a worthless mongrel; so it is with Dow's Theory. I have recently read that the Dow Theory can help one pick stocks that will triple, that it can create profits on demand at a given time, that it is and has been infallible, that the interday price movements have meaning under the Dow Theory, that the utility average has predictive value, that the short interest ratio and odd-lot index are an integral part of the Theory (not merely technical aids), that the Theory can accurately estimate the height of a bull swing or the depth of a reaction, and that those who write about the Dow Theory are somehow connected with Dow, Jones & Co. There is, of course, no truth in any of these assertions.

Those of us who have affection for the Theory are saddened when it is presented to the public in a bastardized version by organizations who possess imposing addresses, "large staffs," and who indulge in blatent advertising which misleads the public. Robert Rhea's brilliant letters were written by Rhea himself from his bed (he was an invalid). I have seen no better series of Dow Theory letters since. I suppose I should feel that any service that advertises and stimulates interest in the Dow Theory will also indirectly stimulate interest in this Service. Nevertheless, I believe that improper presentation and fallacious claims hurt the Dow Theory and in the final analysis benefit nobody.

THE MARKET. Amateurs are always surprised and disconcerted when, after a burst of glowing business news, the stocks which they purchased because of that news hesitate and even decline. They cannot seem to comprehend the fact that the market may have been discounting this good news for as far ahead as six months to a year. In a letter written July 28, 1958, I quoted Hamilton as saying, "Every major (market) swing is justified by the subsequent condition of the country's business." I used this quote at a time when the nation's economy appeared anything but promising, and when many security analysts were proclaiming that the rising stock market had taken leave of its senses. It is a pity that so few of these analysts have studied the history of the price movements. An hour of research might have convinced them that the market is never interested in yesterday or today, it is concerned only with tomorrow. And when in the face of bad news the market advances steadily it is then performing its classical function which is prediction.

For this reason it is highly dangerous, after an extended bull swing, to make purchases on the basis of bullish newspaper reports or the optimistic guesses of security analysts. Following a long bull swing the market will advance further only if it sees additional signs of economic improvement that have not at the time been discounted. Those who buy on bullish news while ignoring the movements of the averages will live to learn the folly of attempting to out-guess the price movements.

As it happens, I do not feel that we have seen the real public participation in this market. We have yet to see the 5-6-7 million share days which were characteristic of 1929; we have not seen the majority of low-priced stocks make the breath-taking moves which should be seen in a bull market of this size. This, of course, does not mean that the market must now travel in a straight-up line. All bull swings have been corrected; this one will be no exception.

It is becoming obvious that we must depend increasingly on the public to buy this market. The odd-lotter is purchasing on balance day after day; he always does when the picture is rosy. Over the last month it is interesting to note that despite optimistic statistics on steel production, automobile output and consumer buying, the prices of high-grade stocks have held remarkably steady. The implications are that there were plenty of shares offered to buyers on the good news. At 3.37% yield on the D-J industrials informed investors are as apt to be sellers as buyers, and this is the reason for my statement that we must depend more and more on the crowd to keep buying.

PRICE MOVEMENTS. The lows established on last week's decline (indust. 588.53; rails 161.13), having come after new highs, now become the only significant downside points. Should one or both averages continue to hold above these lows the implications would be for an eventual bullish penetration of the highs. If both averages violate the lows (particularly on increasing volume) the indications would be for a decline or possibly a secondary reaction. We cannot determine the extent of a reaction, but this writer would immediately take additional profits if the two downside points were broken.

Volume indications have been extremely unsatisfactory during the last few weeks, offering no clues as to an eventual upside or downside breakout. If the rails worked up a little higher I would call this area a "line." Lines possess important forecasting value, and a penetration of both averages above the line limits would predict a continuation of the advance while a downside penetration of the line would mean generally lower prices. Purchases or sales should be made only on joint penetrations of the line as stated before. If volume dries up as the lower line limits are approached bullish inferences may be drawn. It is also bullish if volume expands as prices rise. The longer the two averages hold within this area, the more hopeful the picture becomes. Optimists may breathe easier in the knowledge that most lines are eventually broken topside in bull markets.

I want to stress that in the event of a reaction, this bull market will not have ended. The rails have still not confirmed their 181.23 highs of 1956. Before this bull market is over the rails will go over their former highs by at least one cent or this will be a different market than any I have ever seen or studied.

Many readers may feel I am holding out on them at this point. I can only answer that I am not, and that my experience has been that in areas such as this the more positive the analyst the bigger the quack. Those who have studied the history of the averages prefer, when in a line, to allow the market to tell its own story.

STOCKS. I am still hopeful on STUDEBAKER PACKARD but would clear out quickly if it broke 12-1/2 on volume. Would sell LITTON if it breaks 74, LOCKHEED if it breaks 30. DOW CHEMICAL, MINNESOTA MINING, EASTERN AIR LINES, EMERSON RADIO all look good on my charts and positions should be held. The charts look poor on BELL AIRCRAFT and CHEMETRON and I would sell these now.
(written February 4 - 8:00 P.M.)

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